



March 2017

DEFENSE COMMISSARIES

DOD Needs to
Improve Business
Processes to Ensure
Patron Benefits and
Achieve Operational
Efficiencies

GAO Highlights

Highlights of [GAO-17-80](#), a report to congressional committees

Why GAO Did This Study

DOD operates 238 commissaries worldwide to provide groceries and household goods at reduced prices as a benefit to military personnel, retirees, and their dependents. Since 2010, Congress appropriated an average \$1.4 billion annually to help fund commissary operations.

Senate Report 114-49 included a provision for GAO to review aspects of commissary operations. This report (1) determines the extent to which DOD has assurance it is maintaining its desired savings rate for patrons and (2) identifies differences in business practices between commissary operations and commercial grocery store practices. GAO analyzed data on savings, sales, and costs. GAO also reviewed leading practices relevant for commissary operations; assessed the costs for service contracts and product distribution options; and conducted site visits to a nongeneralizable sample of 12 commissaries based on, among other things, location and sales.

What GAO Recommends

GAO is making three recommendations, including that DOD address limitations identified in its savings rate methodology; develop a plan with objectives, goals, and time frames to improve efficiency in product management; and conduct comprehensive cost-benefit analyses for service contracts and distribution options. DOD concurred with GAO's first two recommendations and partially concurred with the third recommendation. GAO continues to believe the cost-benefit analysis recommendation is valid.

View [GAO-17-80](#). For more information, contact Brian J. Lepore at (202) 512-4523 or leporeb@gao.gov.

March 2017

DEFENSE COMMISSARIES

DOD Needs to Improve Business Processes to Ensure Patron Benefits and Achieve Operational Efficiencies

What GAO Found

The Department of Defense (DOD) lacks reasonable assurance that it is maintaining its desired savings rate for commissary patrons. The Defense Commissary Agency (DeCA), which manages the commissaries, has a methodology for calculating the annual savings rate that patrons realize by shopping at commissaries rather than commercial grocery stores. In fiscal year 2015, the most recent data available at the time of our review, DeCA's Board of Directors approved a desired average savings rate of 30 percent based on savings calculated for prior years using the methodology. However, GAO found weaknesses in this methodology. For example, the methodology does not use a random sample of overseas commissaries or account for seasonal and geographic variations in item prices. Because of these weaknesses, DOD's methodology can potentially result in an inaccurate calculation of the actual savings rate that commissary patrons experience. DeCA officials stated that the agency plans to revise the savings methodology to address the limitations GAO identified. Because this effort is underway, it is too early to know whether the revisions will address the limitations GAO identified.

Differences exist between certain business processes used at the commissaries and those of commercial grocery stores.

First, DeCA tracks the sale of products at all commissaries but does not assess the contribution of the sale of each product to a given store's total sales in determining which products to sell. According to DeCA officials, because commissaries are focused on providing a benefit rather than on maximizing profits like commercial grocery stores, commissaries do not always adjust products they carry based on customer demand. DeCA officials said that they would like to be more efficient, but have not developed a plan with achievable objectives, goals, and time frames regarding how to improve product management based on sales and customer demand. Without improving the management of products based on sales and customer demand as is done in commercial grocery stores, DeCA may be missing opportunities to increase sales, leverage efficiencies, and achieve savings in commissary operations. Second, DeCA has not conducted cost-benefit analyses for costs associated with (1) the use of stocking and custodial service contracts as compared with the use of in-house staff and (2) product distribution options across all commissaries. For example, DeCA uses services contracts at most commissaries, totaling about \$137 million in fiscal year 2015, even though our analysis suggests that using in-house personnel for stocking may be more cost effective. Commercial grocery stores are generally sensitive to the cost of business operations, competition in their market, and the need to generate a profit. In addition, different product distribution options could result in significant savings impacting the price a commissary patron pays for a product. According to DeCA officials, DOD does not require cost-benefit analyses to compare alternative options for service contracts or for the distribution of products to commissaries. However, without conducting such analyses to guide its decision making on these business processes, DeCA is not positioned to determine whether it is using its resources most efficiently.

Contents

Letter		1
	Background	5
	DeCA Lacks Reasonable Assurance That It Has Maintained Its Desired Savings Rate	9
	DeCA Employs a Business Model That Departs from Practices Generally Employed by Commercial Grocery Stores	15
	Conclusions	30
	Recommendations for Executive Action	31
	Agency Comments and Our Evaluation	32
Appendix I	Scope and Methodology	35
Appendix II	Comments from the Department of Defense	40
Appendix III	GAO Contact and Staff Acknowledgments	46
Tables		
	Table 1: Comparison of Savings Rates for Customers Shopping at Commissaries Compared with Rates at Retail Grocery Stores, across Different States and Overseas for Fiscal Year 2015	10
	Table 2: Costs for In-House Versus Contracted Stocking and Custodial Services, by Commissary Size for Fiscal Year 2015	25
Figures		
	Figure 1: DeCA's Allocation of \$1.3 Billion in Appropriated Funds for Commissary Operations for Fiscal Year 2015	8
	Figure 2: Costs Included in DeCA Pricing for Products Compared with Commercial Grocery Store Pricing	17
	Figure 3: Selected Commissaries with the Highest Total Sales	19
	Figure 4: Selected Commissaries with the Lowest Total Sales	20
	Figure 5: Comparison of Average Costs for In-House Versus Contracted Stocking and Custodial Services, by Commissary Size for Fiscal Year 2015	25
	Figure 6: Product Delivery Options for DeCA Commissaries	28

Abbreviations

DeCA	Defense Commissary Agency
DOD	Department of Defense
OMB	Office of Management and Budget

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



March 23, 2017

The Honorable John McCain
Chairman
The Honorable Jack Reed
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Mac Thornberry
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

Defense commissaries are intended to enhance the quality of life of active-duty personnel, military retirees, and their dependents, and support military readiness, recruitment, and retention goals. The defense commissaries comprise a worldwide chain of stores that, as required by law,¹ provide groceries and household goods to their patrons at reduced prices. Commissaries are not expected to be self-supporting, and Congress appropriated an average of \$1.4 billion annually from fiscal years 2010 through 2015 to help fund their operations.² The Department of Defense (DOD) estimates that a family of four can save about \$4,400 annually (or approximately 30 percent) by shopping at a defense commissary instead of at a commercial grocery store.³ This savings is considered a noncash benefit.

The Defense Commissary Agency (DeCA) manages defense commissaries. DeCA reports to the Office of the Secretary of Defense, and is governed by a Board of Directors comprising representatives from each of the military services. As of April 2016, DeCA operated 238 commissaries worldwide—177 in the United States and 61 overseas—and its total annual sales for fiscal year 2015 were about \$5.5 billion.

¹10 U.S.C. § 2481.

²10 U.S.C. § 2483.

³See Defense Commissary Agency (DeCA) News Release, "Senior Enlisted Advisor Promotes Commissary Benefit," March 18, 2011.

DeCA has about 15,000 employees, some of whom are part-time employees, and total labor costs accounted for about \$1 billion, or 73 percent, of the operating costs covered by the annual appropriation in fiscal year 2015. The 2015 National Defense Authorization Act required DOD to conduct a review of commissary management and determine the potential impact of any changes on patron savings. Following up on the 2015 National Defense Authorization Act, there was an additional interest in exploring the possibility of privatizing a portion of commissary operations. Also, DOD proposed that Congress reduce annual appropriations in fiscal year 2017 by \$1 billion over the course of the 5-year period from fiscal year 2017 through fiscal year 2021 and that Congress allow the department to adopt some business practices commonly used by commercial grocery stores that would enable commissaries to be at least partially self-sustaining, thus reducing taxpayer costs.⁴

Senate Report 114-49 accompanying a bill for the National Defense Authorization Act for Fiscal Year 2016 included a provision for us to analyze and review certain aspects of commissary operations. Accordingly, this report (1) determines the extent to which DOD has assurance it is maintaining its desired savings rate (nonpay cash benefit) for patrons and (2) identifies differences in business practices between commissary operations and commercial grocery store practices.⁵

To address both objectives, we assessed information provided by DeCA headquarters and conducted site visits to a nongeneralizable sample of 12 commissaries.⁶ We selected these commissaries to reflect various characteristics such as location, sales, operating costs, and the representation of all military services. Results from this nongeneralizable sample cannot be used to make inferences about all commissaries but provide insight into the costs and management of commissaries.

⁴See Department of Defense, Office of the Under Secretary of Defense (Comptroller) Chief Financial Officer, *Defense Budget Overview: United States Department of Defense Fiscal Year 2017 Budget Request* (Washington, D.C.: February 2016).

⁵We provided a briefing of our preliminary observations to the Senate Armed Services Committee and House Armed Services Committee in February 2016.

⁶The 12 commissaries we visited are located at Fort Belvoir, Fort Lee, Naval Air Station Oceana, and Joint Expeditionary Base Little Creek-Fort Story, Virginia; Tobyhanna Army Depot, Pennsylvania; Schofield Barracks, Joint Base Pearl Harbor-Hickam, and Marine Corps Base Hawaii, Hawaii; and Naval Base San Diego, Naval Air Facility El Centro, and Marine Corps Air Ground Combat Center Twentynine Palms, California.

To determine the extent to which DOD has assurance it is maintaining its desired savings rate for patrons, we reviewed DeCA's guidance and methodology for calculating the patron savings rate from fiscal years 2010 through 2015, the most recent fiscal year for which data were available at the time of our review. We compared DeCA's savings methodology with relevant leading practices for cost estimating and sampling, such as sampling standards established by the American Association for Public Opinion Research Report Task Force on Non-Probability Sampling,⁷ and with federal standards for internal control, which states that management should have relevant and reliable information to run an agency's operations and the data should be reasonably free of error and bias and represent what they were purported to represent.⁸ We interviewed DeCA officials responsible for collecting, tracking, and analyzing sales, prices, costs, and savings information at DOD commissaries to corroborate our understanding of DeCA's methodology for calculating the patron savings rate.

To identify differences in business practices between commissary operations and commercial grocery store practices and their implications for operational efficiencies and costs, we reviewed pricing methods, product management,⁹ and certain business processes such as those pertaining to stocking and custodial services and distribution. We compared DeCA's pricing method as required by statute with practices used in the private sector.¹⁰ We identified private sector practices by reviewing pertinent studies that describe operational efficiencies achieved in the private sector and through discussions with representatives of

⁷We used the American Association for Public Opinion Research Report Task Force on Non-Probability Sampling as an authoritative source for sampling because it identifies the strengths and weaknesses of key sampling methods related to the use of probability and nonprobability samples for making inferences from a sample to a larger population. Reg Baker et al, *Report of the American Association for Public Opinion Research Task Force on Non-Probability Sampling*, June 2013.

⁸GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

⁹Product management, or category management, refers to a concept used in private retail where retailers organize products sold through a combination of assortment, pricing, promotion, profitability, and shelving strategies.

¹⁰Section 2484(e) of Title 10 of the U.S. Code sets forth how commissary item sale prices are to be established.

commercial grocery stores and retailer associations.¹¹ We also reviewed DeCA's plans to change the current pricing method.

With regard to stocking and custodial services, we reviewed DeCA's guidance related to these business processes and obtained information on how DeCA decides whether to contract for these services or use in-house staff. For distribution processes, we reviewed costs associated with DeCA-owned or leased vehicles and DeCA warehouses both domestically and overseas, as well as other options for product distribution. We also compared DeCA's guidance for reviewing contracts against DeCA acquisition regulations, federal government guidelines, and federal standards for internal control.¹² We interviewed DeCA headquarters officials and officials at local commissaries responsible for contracting to identify and assess the implementation of contracts at the local level.

We assessed the reliability of data on savings rates, sales, and contracting information provided by DeCA by (1) reviewing related documentation, such as recent studies, and (2) interviewing DeCA officials who were knowledgeable about the data. We asked the officials questions intended to assess the reliability of the data, including questions about the purpose for which the data were collected, the source of the data, and how the data were compiled. On the basis of procedures performed, we have concluded that these data were sufficiently reliable for the purposes of reporting on data related to savings, sales, and salaries used for contracting and custodial services. See appendix I for additional details on our scope and methodology.

¹¹See Boston Consulting Group, *Military Resale Study, Assessment of Opportunities for the Defense Commissary Agency and Evaluation of Consolidation in the Broader Military Resale System*, July 10, 2015; Military Compensation and Retirement Modernization Commission, *Report of the Military Compensation and Retirement Modernization Commission*, Final Report, 2015; RAND, *The Likely Effects of Price Increases on Commissary Patronage: A Review of the Literature*, 2015; Booz Allen Hamilton Inc., *Independent Study of Defense Commissary Agency's Engineering Directorate*, 2014; Dove Consulting, *Variable Pricing Feasibility Assessment for Defense Commissary Agency*, 2004; and Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options*, 2011.

¹²DeCA, *Defense Commissary Agency Acquisition Regulation Supplement*, 1999; Office of Management and Budget (OMB), *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*, OMB Circular No. A-94 (March 1992) and *Management's Responsibility for Internal Control*, OMB Circular No. A-123 (revised 2004); and [GAO-14-704G](#).

We conducted this performance audit from September 2015 to March 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

DOD Guidance for Establishing and Closing Commissaries

By law, DOD's primary consideration for establishing and closing commissaries is the needs of the members of the armed forces on active duty and their dependents.¹³ DOD Instruction 1330.17 outlines requirements for establishing and closing commissaries.¹⁴ Under the instruction, DOD can establish commissaries only where (1) the location has a military mission and a minimum active-duty population of at least 500 active, reserve, or National Guard personnel and (2) the location is part of DOD's real property inventory.¹⁵ For commissaries in locations that DOD considers to be remote and isolated, the Assistant Secretary of Defense (Readiness and Force Management) may grant an exception from the requirement to have a minimum active-duty population of 500 personnel.¹⁶ DOD Instruction 1015.10, which defines remote and isolated, lists factors to establish and maintain a location's remote and isolated status, which must be documented and updated if circumstances change substantially. According to DeCA, as of April 2016, there were 29

¹³In addition, when assessing whether to close a commissary store, DOD is also required to consider the needs of members of the reserve components of the armed forces. 10 U.S.C. § 2482(c)(2).

¹⁴Department of Defense Instruction 1330.17, *DOD Commissary Program* (June 18, 2014).

¹⁵DOD's real property inventory is a comprehensive listing of installations and sites owned by DOD.

¹⁶DOD Instruction 1330.17 allows for the exception where a U.S. site has been designated as remote and isolated in accordance with DOD Instruction 1015.10, *Military Morale, Welfare, and Recreation (MWR) Programs* (July 6, 2009, incorporating Change 1, May 6, 2011). The major factors in determining if a location obtains remote and isolated status are the installation's financial capability, performance, and degree of assistance provided by the major command and military service. In addition, other extenuating circumstances, including special security conditions, short tour locations, and significant cultural differences, may be considered.

commissaries that are located in remote and isolated areas. DOD's instruction also provides specific requirements for closing commissaries, including if the location (1) no longer is managed as part of DOD's real property inventory, such as if the site is closed under a Base Realignment and Closure round recommendation¹⁷ and (2) no longer has a military mission or an active-duty population—specifically if there are not at least 100 active, reserve, or National Guard personnel on active duty permanently assigned to the installation or location.

Our Prior Work on Defense Commissaries

We have previously reported on DOD's commissary operations as well as other privatization efforts within the department. For example, in November 2016, we reported that DOD's budget neutrality report for the commissaries and exchanges did not include any assumptions, methodology, or specific time frames related to cost savings initiatives totaling \$2 billion in reductions over a 5-year period from fiscal year 2017 through fiscal year 2021.¹⁸ We also found that DOD's report did not define specific metrics for benchmarks for customer satisfaction, quality of products, and patron savings. We recommended that DOD provide information to Congress to support the department's conclusion about budget neutrality, develop a plan for achieving alternative reductions to appropriations, and identify specific metrics for customer satisfaction, quality of products, and patron savings. DOD concurred with our recommendations.

In April 2011, we reported that some of the general and economic criteria in DOD's instruction were not clear on when to establish or continue a commissary versus when to discontinue commissary operations at Naval Air Station Brunswick, Maine.¹⁹ For example, DOD's instruction stated

¹⁷Congress may authorize rounds of Base Realignment and Closure, pursuant to the Defense Base Realignment and Closure Act of 1990, as amended, as a means of reducing excess infrastructure and realigning bases to meet changing force structure needs.

¹⁸DOD interpreted the term "budget neutrality" as ending the use of appropriated funding for commissaries and exchanges. The military services' exchanges are retail stores that provide goods and services as well as some groceries similar to the commissaries. See GAO, *DOD Commissaries and Exchanges: Plan and Additional Information Needed on Cost Savings and Metrics for DOD Efforts to Achieve Budget Neutrality*, [GAO-17-38](#) (Washington, D.C.: Nov. 10, 2016).

¹⁹See GAO, *Defense Infrastructure: DOD Used Available Guidance in Its Decision to Discontinue Commissary Operations at NAS Brunswick, but Criteria Needs Clarification*, [GAO-11-266R](#) (Washington, D.C.: Apr. 20, 2011).

that the primary consideration in assessing the need for a commissary and selecting the location of the store—including whether to operate commissaries on closed installations—is the effect on active-duty personnel and their dependents. However, the instruction did not specify how this effect should be measured and used as decision criteria. Additionally, at the time of our review, the instruction stated that “as a general rule, commissary operations are discontinued when an installation is completely closed and no active-duty or reserve component personnel remain on the installation.” However, we found that it was unclear what conditions would warrant an exception to the general rule and how the general rule relates to the other criteria for closing a commissary. As a result, we recommended that DOD revise and clarify its guidance. DOD concurred with and implemented our recommendation.

In July 2010, we reported that the Army experienced challenges with its efforts to privatize its lodging facilities.²⁰ Specifically, the Army pursued privatization to obtain private-sector financing in order to address poor conditions of its facilities. We made recommendations related to the Army needing to assess the costs and benefits of future privatization efforts and to the need for DOD to incorporate lessons learned in future privatization efforts within the department. DOD concurred and implemented our recommendations.

DOD’s Annual Appropriation

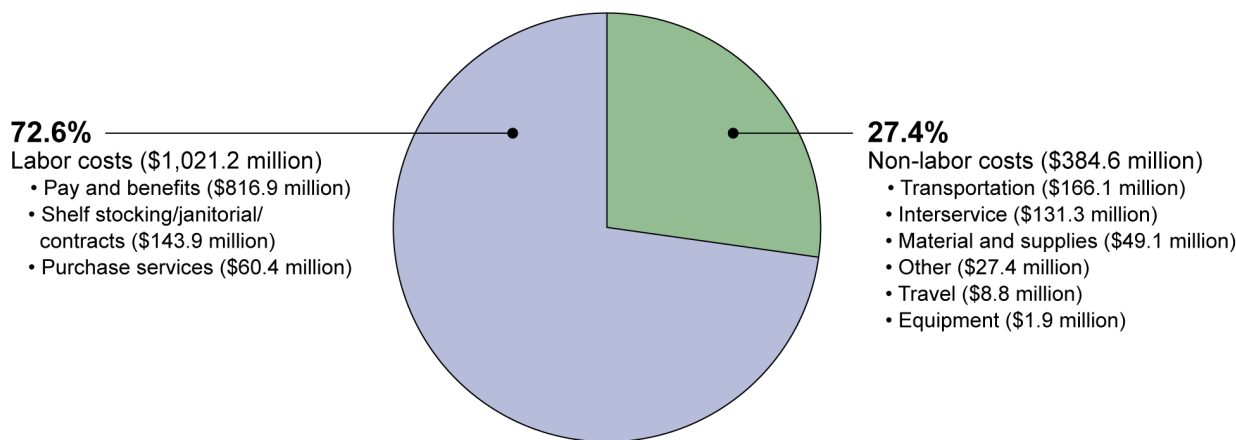
DeCA is required by law to use appropriated funds to cover commissary operating costs, which subsidizes the price of groceries and household goods for patrons shopping at commissaries.²¹ In fiscal year 2015, DeCA received \$1.3 billion in appropriations. DeCA also is governed by regulations that may limit its ability to control costs and allocate funds in the same way as commercial grocery stores, which do not operate under

²⁰See GAO, *Defense Infrastructure: Army’s Privatized Lodging Program Could Benefit from More Effective Planning*, [GAO-10-771](#) (Washington, D.C.: July 30, 2010).

²¹Appropriated funds shall be used to cover operating costs, including the following: salaries and wages of employees of the United States, host nations, and contractors supporting commissary store operations; utilities; communications; operating supplies and services; second destination transportation costs within or outside the United States; and any cost associated with above-store-level management or other indirect support of a commissary store or a central product processing facility, including equipment maintenance and information technology costs. 10 U.S.C. § 2483. There are also some operating costs that DeCA does not have compared with commercial grocery retailers, which typically pay rent as a cost of doing business, and thus these costs are not included in appropriations.

such regulatory requirements. For example, under law, DeCA employees are subject to civil service rules, including the General Schedule pay scales and Office of Personnel Management regulations on personnel policies such as hiring, pay, and retention, but that are not sensitive to local market conditions such as local labor costs as would be true for a commercial grocery store. Figure 1 shows how DeCA allocated \$1.3 billion in appropriated funds by labor and non-labor operating costs in fiscal year 2015.

Figure 1: DeCA's Allocation of \$1.3 Billion in Appropriated Funds for Commissary Operations for Fiscal Year 2015



Source: GAO analysis of Defense Commissary Agency data. | GAO-17-80

Note: Numbers do not add up to the total due to rounding.

Private Business Concepts at the Commissaries

When DOD established DeCA in 1991, it consolidated the management of separate grocery stores run by the Army, the Air Force, the Navy, and the Marine Corps. According to DeCA officials, the consolidation helped reduce costs by combining buying power and sharing overhead. In recent years, several studies reviewed the potential impact of employing business concepts normally used in commercial grocery stores, such as variable pricing and improvements in product management, in commissary operations. For example, in 2015 the Military Compensation and Retirement Modernization Commission (Military Commission) and Boston Consulting Group both recommended ways to reduce annual appropriated funds of commissaries by implementing private business concepts. Specifically, the Military Commission recommended several operational efficiencies, including consolidating commissaries with exchanges, which are retail stores not funded with appropriations and comprise a mix of department stores; convenience stores; and fast food

outlets, among others, and are managed by each of the military services.²² The Boston Consulting Group made recommendations related to employing variable pricing and to product management.²³

DeCA Lacks Reasonable Assurance That It Has Maintained Its Desired Savings Rate

DOD has a methodology to calculate the patron savings rate at commissaries, but lacks reasonable assurance that it is maintaining its desired savings rate for patrons because of weaknesses in this methodology. DeCA's Board of Directors annually recommends the patron savings rate that is to be the price differential commissary patrons are to obtain by shopping in commissaries rather than at commercial grocery stores. Based on past calculations of the savings rate, the Board recommended a desired average savings rate of 30 percent for fiscal year 2015. DeCA's methodology for calculating savings uses weighted averages of product prices. However, aspects of DeCA's methodology are not consistent with leading practices for cost estimating and sampling. As a result of these weaknesses, DeCA lacks reasonable assurance that the desired 30 percent rate recommended by the Board reflects the actual experience of commissary patrons.

DeCA's Savings Calculation Methodology Uses Weighted Averages of Product Prices

DeCA uses weighted averages of product prices to calculate the savings rate,²⁴ and DeCA's methodology differs for commissaries in the continental United States and for those in Hawaii, Alaska, and overseas. For commissaries in the continental United States, DeCA divides products into seven categories ranging from fresh meat and produce to nonfood items with universal product codes (i.e., bar codes).²⁵ For products with bar codes, DeCA compares commissary and commercial prices for over 38,000 items. Specifically, it compares prices on

²²The Military Commission was established by the National Defense Authorization Act for Fiscal Year 2013 to conduct a review of military compensation and retirement systems and to make recommendations to modernize such systems. Pub. L. No. 112-239, § 671 (2013), as amended by Pub. L. No. 113-66, § 1095(b) (2013). See *Report of the Military Compensation and Retirement Modernization Commission*, 2015.

²³Boston Consulting Group, *Military Resale Study: Assessment of Opportunities for the Defense Commissary Agency and Evaluation of Consolidation in the Broader Military Resale System*, 2015.

²⁴A weighted average is the average of the values of a set of items and each of the items are assigned a weight relative to its frequency or importance.

²⁵DeCA's seven categories are meat, produce, dairy, grocery food, frozen, health and beauty, and nonfood groceries.

commissary items during the first 6 months of the calendar year with average national product prices provided by a leading survey.²⁶ For products lacking a bar code, DeCA conducts physical audits at local commercial grocery stores with similar products for a selected sample of 30 commissaries.²⁷ For the meat and produce samples, DeCA collects price data annually in August and September. The seven categories' prices are weighted using a consumer expenditure survey published by the Bureau of Labor Statistics.

For commissaries in Alaska, Hawaii, and overseas, DeCA calculates the weighted average of savings for a selected sample of commissaries based on savings by total sales in each geographic region.²⁸ DeCA physically collects prices for about 200 items across the same seven product categories from a sample of commissaries in Alaska and Hawaii. At other overseas commissaries, DeCA conducts more limited sampling from 13 commissaries. As shown in table 1, DeCA's calculation of the savings rate varies by geographic region.

Table 1: Comparison of Savings Rates for Customers Shopping at Commissaries Compared with Rates at Retail Grocery Stores, across Different States and Overseas for Fiscal Year 2015

Location	Savings rate (percent) ^a
Contiguous states (48)	26.5%
Alaska	33.6%
Hawaii	50.1%
Overseas	34.9%
Worldwide	29.0%

Source: DeCA (2016). I GAO-17-80

^aThe savings rate is calculated as a weighted average based on the market shares from sales in the previous fiscal year.

²⁶DeCA uses comparison data based on the Nielsen survey for nationwide private sector retailers. Nielsen surveys private retail grocery outlets in the continental United States and covers more than 90 participating retail chains.

²⁷In fiscal year 2015, DeCA selected a stratified random sample of commissaries in the continental United States by grouping commissaries by six regions and two size categories based on dollar sales.

²⁸DeCA, *Commissary 2014 Price Comparison Survey*.

DeCA's Savings Calculation Methodology Has Several Weaknesses

When compared with leading practices for cost estimating and sampling, DeCA's savings calculation methodology has several weaknesses that could lead to an inaccurate calculation of the actual savings rate that commissary patrons experience. According to leading practices and federal standards for internal control, management should have relevant and reliable information to run its operations and the data should be reasonably free of error and bias and represent what they were purported to represent.²⁹ However, our analysis showed that DeCA's methodology for determining the savings rate is not fully consistent with leading practices in five areas. As a result, DeCA lacks reasonable assurance that patrons are receiving the full desired value of the nonpay cash benefit represented by the 30 percent savings rate approved by the Board of Directors.

- **Seasonal sales prices:** DeCA's methodology does not account for seasonal differences in prices. DeCA collects its product price samples during the first 6 months of the calendar year for categories, such as dairy, grocery food, frozen, and health and beauty products in the continental United States, which is not representative of the whole year and omits potentially reduced prices commercial grocery stores may offer during the winter holidays. DeCA officials acknowledged that they do not account for winter holiday season price fluctuation, but stated that 6 months is a sufficient period of time for the sample. However, according to nonprobability sampling standards published by the American Association for Public Opinion Research, this type of omission creates a coverage error by underrepresenting part of the sample and generates potential bias. By limiting data collection to the first 6 months of the year, DeCA lacks reasonable assurance that its methodology results in an accurate comparison between commissary and commercial prices over the full year.
- **Sampling overseas commissaries:** While DeCA employs a methodology for randomly selecting 30 commissaries in the continental United States in its savings market basket analysis, the agency lacks a similar methodology for selecting overseas commissaries. Specifically, DeCA officials stated that they ask regional directors to select the overseas commissaries to be included in the sample. However, according to the report on nonprobability sampling by the American Association for Public Opinion Research, a nonrandom sampling method should be based on procedures to provide estimates and some measure of their reliability to help avoid

²⁹[GAO-14-704G](#).

potential sources of bias. Examples of bias include sampling based on convenience or a sample that is small and unrepresentative of the total populations. By giving regional directors the discretion to select overseas commissaries, DeCA is not using a random sampling method and the results of its savings analysis may be subject to potential sources of bias and may not be representative.

- **Geographic price differentiation:** DeCA's methodology does not account for differences in prices based on geographic location. As discussed earlier, DeCA uses the Nielsen survey that aggregates prices nationwide to compare with commissary prices. DeCA does not compare its prices with prices charged by local competitors near its commissaries. In contrast, commercial grocery stores generally compare their prices with prices charged by competitors in the same market since they are subject to comparable local costs of business operations.³⁰ Examples of comparable local costs include the costs of labor and any applicable property or other taxation. Prices at commercial grocery stores generally reflect local market conditions, leading to higher retail prices in higher cost areas and lower prices in lower cost areas. Conversely, the commissaries are somewhat insulated from local market conditions since commissaries pay their employees according to the federal pay system, which is not tied directly to the local labor market; operate from government-owned military bases that are not subject to property taxes; and have an annual appropriation to subsidize operations. Because DeCA's methodology does not differentiate from high to low cost areas, the patron savings rate is potentially inaccurate across different regions. For example, the savings rate is likely to be lower in areas with a low cost of operations and higher in areas with a high cost of operations.³¹ In July 2016, DeCA officials stated that they are considering revising

³⁰For more information about private sector practices with regard to pricing, see Boston Consulting Group, *Military Resale Study: Assessment of Opportunities for the Defense Commissary Agency and Evaluation of Consolidation in the Broader Military Resale System*, 2015; Bruce Greenwald and Judd Kahn, *All Strategy Is Local*, *Harvard Business Review*, September 2005; and Paul B. Ellickson, Sanjog Misra, and Harikesh S. Nair, *Repositioning Dynamics and Pricing Strategy*, *Journal of Marketing Research*, Volume 49 (6), September 10, 2012.

³¹According to the Boston Consulting Group, DeCA's pricing model generally allows lower cost-of-living areas to receive a benefit far lower than the average savings rate. Although military patrons typically receive three key types of locality-based pays, such as housing allowance, basic pay, and basic allowance for subsistence, the Boston Consulting Group determined that any changes to DeCA's pricing model would have minimal impact on the cost of living allowance provided by DOD within the continental United States. See Boston Consulting Group, *Military Resale Study*, 2015.

the savings methodology to include more comparisons with local commercial grocery stores.³²

- **Private labels:** DeCA's methodology does not account for lower priced private labels. DeCA compares prices and savings only across major name brands and grocery products that are sold by commissaries and commercial grocery stores and excludes private-label items.³³ However, patrons at commercial stores typically shop for a mix of private-label and name-brand products, so DeCA's exclusion of private labels likely leads to an overstatement of the savings rate. DeCA officials told us that they are working with the Boston Consulting Group to conduct a pilot program to implement private labeling at a select sample of commissaries for a limited time period. The sample of commissaries and time period had not been determined at the time of our review.³⁴ According to DeCA officials, the pilot would help DeCA to more accurately compare the cost of shopping at commissaries with commercial grocery stores.
- **Weighted averages for quantities of items sold:** DeCA does not use weighted averages to account for variance in the quantities of different products sold at its commissaries. As discussed earlier, DeCA uses a weighted average to calculate savings at some locations based on market shares from sales in the previous fiscal year. However, DeCA does not use a weighted average when comparing product prices with those of commercial grocery stores. Instead, DeCA aggregates the prices of all commissary items within a category (e.g., meat or produce) rather than using a weighted average that takes into account differences in quantities sold across products. For example, when DeCA calculates the average savings rate within the meat category, the agency assumes the same quantities are sold

³²According to DeCA officials, DeCA is revising the savings methodology based on regional comparisons because the cost of groceries varies widely by region.

³³Private label items are products generally intended to be comparable to and sometimes less expensive than name brand products and are commonly referred to as "store brands." DeCA currently does not carry private label items.

³⁴Section 651 of the National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, directs that DOD develop a plan to achieve budget neutrality for the commissary system by October 2018, and also authorizes DOD to conduct pilot programs to evaluate the feasibility and advisability of processes and methods for achieving budget neutrality. See DOD, *Report on Plan to Obtain Budget Neutrality for the Defense Commissary System and the Military Exchange System* (May 2016), Report to Congress in accordance with Section 651 of the National Defense Authorization Act for Fiscal Year 2016 (P.L. 114-92).

for all meat products, for example, for T-bone steaks and for ground beef. This methodology assumes that patrons buy the same quantities of differently priced products, an approach that is inconsistent with leading practices.³⁵ Because DeCA's methodology does not account for the variances in the quantities of different products sold within a category, it can result in an inaccurate calculation of the patron savings rate.

The 2015 Boston Consulting Group study also noted weaknesses in DeCA's savings rate methodology. For example, the study estimated that the savings rate between commissary and commercial grocery store prices is lower than 30 percent and ranges from 5 to 25 percent depending upon the location of the commissary because higher cost of living areas enjoy greater savings than lower cost of living areas.³⁶ DeCA officials told us they have used the same savings rate methodology since it was introduced in 2008 and acknowledged they have not validated it for accuracy and consistency.

DeCA officials stated that they have contracted with the Boston Consulting Group to assist in addressing a statutorily authorized pilot program for the commissary system to achieve budget neutrality (i.e., not continuing to rely on appropriations). The effort includes revising its methodology to verify that the approved savings rate is being achieved. Once the savings rate is verified, it will be used as a baseline to assess pilot programs that would include variable pricing and private label brands. At the time of this review, DeCA officials could not provide evidence to support how the revised savings methodology would address all the limitations we identified, including those related to seasonal bias, sampling methodology for overseas commissaries, and geographic differentiation. DeCA officials stated that the agency plans to assess and revise the savings methodology, which may include addressing some limitations such as weighted average calculations. As DeCA takes steps to revise its methodology, an opportunity exists to address the weaknesses we and others have identified. Doing so would provide

³⁵For example, the Bureau of Labor Statistics calculates the Consumer Price Index based on a basket of goods and services that includes prices and quantities. Expenditures are then calculated as prices multiplied by quantities and the cost of living estimated as a percentage change of two levels of expenditures, not just a price comparison or an average price of all products.

³⁶Boston Consulting Group, *Military Resale Study*, 2015.

greater assurance that patrons are experiencing the desired 30 percent savings rate using their commissary shopping privileges.

DeCA Employs a Business Model That Departs from Practices Generally Employed by Commercial Grocery Stores

DeCA's business model for defense commissaries departs from practices generally employed by commercial grocery stores. First, DeCA uses a statutorily required pricing method that differs from the pricing method generally employed by commercial grocery stores. Second, while DeCA tracks products sold in its stores, the agency does not adopt leading practices such as using product demand to determine which products it should stock, potentially limiting the stocking and sales of popular items. Third, DeCA lacks reasonable assurance that certain of its business processes are cost effective.

DeCA Uses a Statutorily Required Pricing Method That Differs from the Method Generally Used by Commercial Grocery Stores

DeCA's commissaries are subject to statutory requirements to implement a pricing method that leads to generally uniform prices for the same product at different locations. By comparison, commercial grocery stores' prices are sensitive to local market operating costs as noted above and include a markup on the price of products to cover operating costs and generate a profit. To address the statutory requirement that DOD plan for the budget neutrality of commissaries, DeCA is considering changes in its pricing method that could enable defense commissaries to incorporate business concepts commonly used by commercial grocery stores.³⁷

³⁷Section 651(e) of the National Defense Authorization Act for 2016 authorizes DOD to conduct one or more pilot programs to evaluate the feasibility and advisability of processes and methods for achieving budget neutrality in the delivery of commissary and exchange benefits. The report describes piloting two different pricing options, such as private labeling and variable pricing that will help DeCA achieve efficiencies. Private label items are products generally intended to be comparable to and sometimes less expensive than name brand products and are commonly referred to as store brands. Variable pricing allows retailers to price goods to cover operating costs and capital expenditures and to generate a profit.

DOD Pricing Method Leads to Mostly Uniform Prices, Whereas Private Sector Prices Are Sensitive to Local Market Costs

By law, DeCA is required to implement a uniform pricing method across its commissaries.³⁸ Under this method, DeCA prices products so that sales of products recoup only the actual product cost from the supplier; the cost of transportation to the place of sale; and the actual or estimated cost of the loss of inventory, plus a 5-percent surcharge.³⁹ The surcharge can be used to fund specific types of activities, such as commissary construction, equipment, repair, software acquisition, and facilities maintenance.⁴⁰ As a result, DeCA officials stated that because their pricing model excludes some costs, such as salaries, benefits, rent, and a profit margin, commissaries provide patron savings when compared with shopping at commercial grocery stores.

By contrast, pricing at commercial grocery stores is sensitive to the cost of business operations, competition in their specific market, and the need to generate a profit. They typically establish prices that account for the full cost of grocery products plus the needed markup for profit. According to private sector guidelines, standard industry practices for pricing include costs, such as salaries and benefits for employees, rent, marketing, and other administrative support costs.⁴¹ However, by law, DeCA cannot include costs such as salaries, employee benefits, and utilities in its retail product prices, and DeCA instead pays these costs using its annual appropriation. Also, according to DeCA officials, unlike commercial grocery stores, DeCA does not pay rent for the use of commissary buildings because DOD owns the facilities, although the agency pays for store construction and maintenance with funds from the 5 percent surcharge. Figure 2 shows DeCA's pricing practices as compared with those of commercial grocery stores.

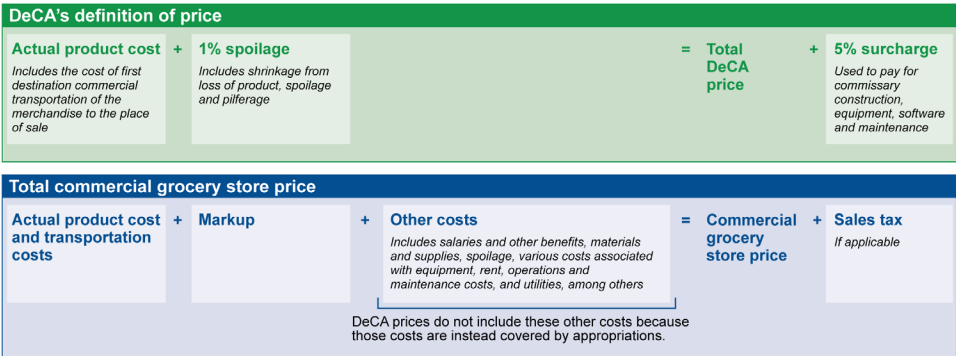
³⁸10 U.S.C. § 2484(e).

³⁹DOD refers to the cost of transportation to the place of sale as the "first destination" transportation cost. Loss of inventory consists of spoilage, pilferage, and shrinkage. According to DeCA officials, DeCA estimates the cost for loss of inventory as an additional 1 percent of product costs.

⁴⁰10 U.S.C. § 2484(h). See also DOD Instruction 1330.17, *DOD Commissary Program* (June 18, 2014).

⁴¹PricewaterhouseCoopers, *Issues and Solutions for the Retail and Consumer Goods Industries: A Comparison of International Financial Reporting Standards and US GAAP*, May 2012.

Figure 2: Costs Included in DeCA Pricing for Products Compared with Commercial Grocery Store Pricing



Source: Defense Commissary Agency (DeCA), Pricewaterhouse Coopers, National Grocers Association, and Food Marketing Institute. | GAO-17-80

DeCA's uniform pricing method results in some differences with commercial grocery stores in how prices are set. Commercial grocery stores use a variable pricing method by which they charge different prices for the same product in different locations, even within the same chain of stores. (Variable pricing is discussed further in the next section of this report). Conversely, DeCA's mandate to charge uniform prices means that prices are generally the same for the same item regardless of local market business conditions, cost of operations, or the presence of competition from commercial grocery stores, so commissary prices are not sensitive to these factors. Moreover, the annual appropriation covers the cost of operations, which serves as a subsidy, as previously noted. DeCA officials told us that the current system results in DeCA using high sales volumes and surcharge revenue collected at some commissaries to offset lower sales at other commissaries—often those at smaller commissaries or those located in remote locations, many of which might be unprofitable if they were commercial grocery stores. For example, DeCA pools the surcharge revenue collectively across all commissaries to help pay for commissary construction and maintenance, among other things.

The uniform pricing method also likely leads to differences in the actual savings rate commissary patrons experience due to commercial grocery stores' sensitivity to local market business operations costs but from which the commissaries are somewhat shielded. Specifically, while commissaries share the same prices for the same products regardless of the market, commercial grocery stores generally price products to recoup the lower or higher operating costs in a given market and maintain a profit margin. Thus, DeCA's uniform pricing method likely results in patrons in

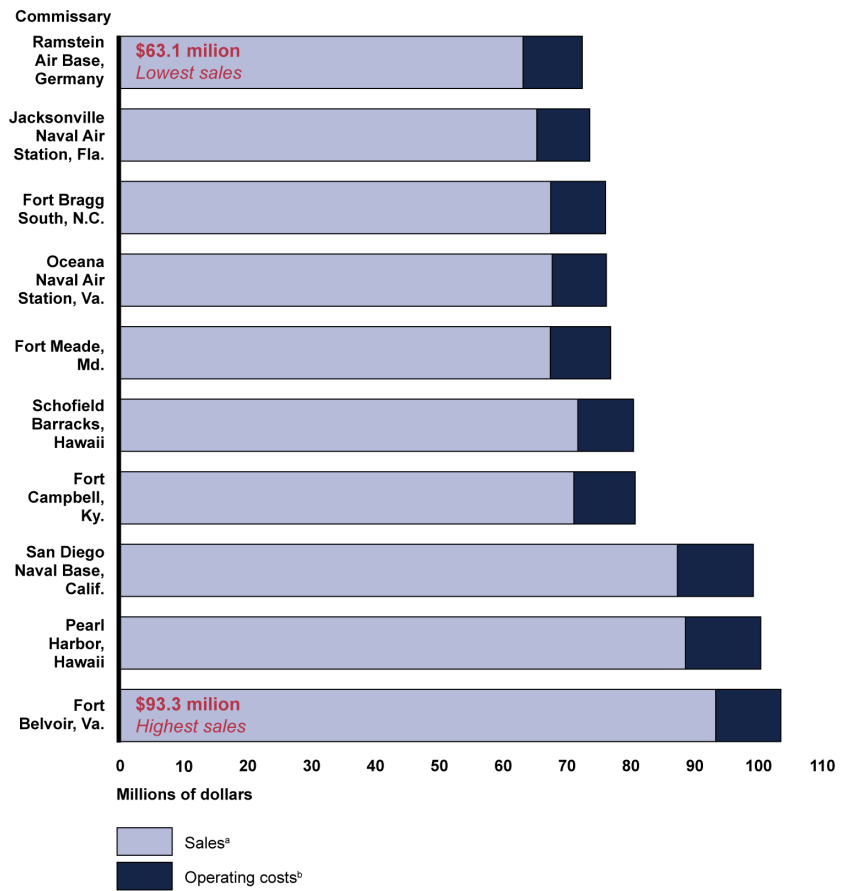
lower cost-of-living areas receiving a lower-than-average savings rate since competing private retail stores can price products lower based on the lower local operating costs but the commissary's product price is static and not sensitive to local market operating costs. By comparison, commissary patrons in higher cost-of-living areas (e.g., Hawaii) are likely to experience a relatively greater savings rate since competing commercial grocery stores must price their products higher to recoup the higher operating costs but, as in the previous example, the commissary's price is uniform and static.

A comparison of the uniform pricing method and commercial grocery store practices reveals another key difference between the commissaries and commercial stores. Commercial grocery store operators are likely to eventually close an unprofitable store when profit and loss—affected by prices—are the key considerations. Conversely, because the commissary business model has a separate funding source (the annual appropriation) that is not linked to sales and prices, DeCA may keep stores open even if the cost of operations exceeds sales revenue. For example, a commissary at Camp Kure, Japan, sold goods totaling \$56,655 in fiscal year 2015 but had operating costs totaling \$71,931, which represents nearly 127 percent of total sales—figures that would be considered unprofitable for a commercial grocery store.⁴² Senior DeCA officials acknowledged that remote and overseas commissaries are unlikely to be profitable under the commercial grocery store business model. On the other hand, some commissaries do generate sales in an amount greater than their operating costs. For example, the commissary at Fort Belvoir, Virginia, sold goods totaling \$93.3 million in fiscal year 2015 and had operating costs of \$10.2 million.⁴³ Figures 3 and 4 shows a comparison of sales and operating costs, which are subsidized through appropriations, for commissaries with the highest and lowest sales.

⁴²In fiscal year 2015, Camp Kure, Japan, received \$2,833 from pooled surcharge funds.

⁴³In fiscal year 2015, Fort Belvoir collected about \$4.7 million in surcharges.

Figure 3: Selected Commissaries with the Highest Total Sales

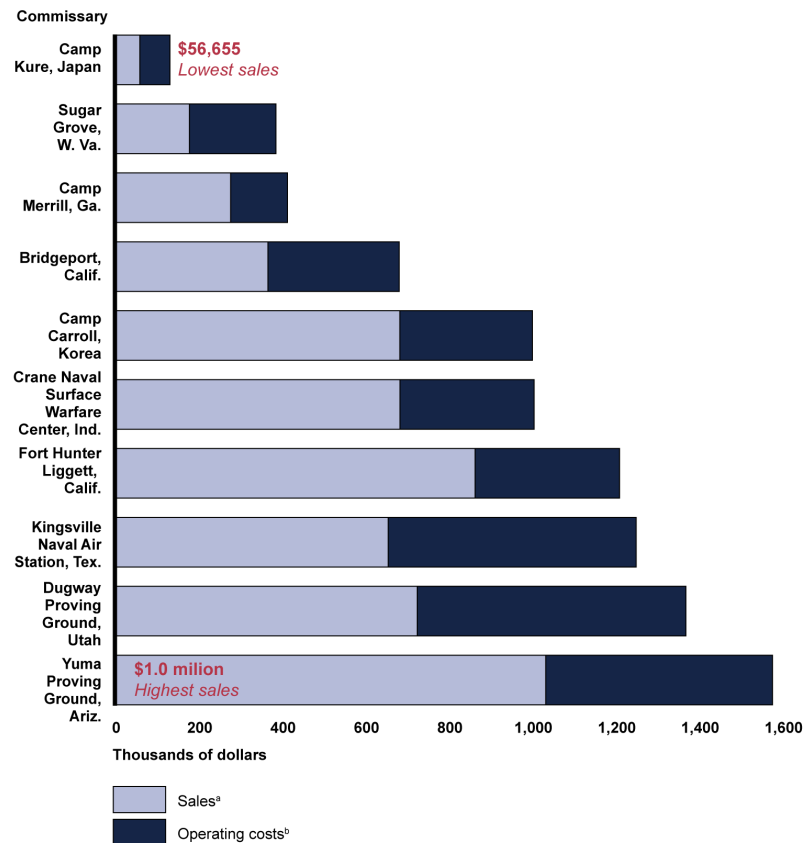


Source: GAO analysis of Defense Commissary Agency data. | GAO-17-80

^aSales refer to the price charged for the product, which includes actual product cost from the supplier, including the cost of transportation to the place of sale.

^bOperating costs are subsidized through appropriations because commissaries are not designed to be self-sustaining.

Figure 4: Selected Commissaries with the Lowest Total Sales



Source: GAO analysis of Defense Commissary Agency data. | GAO-17-80

^aSales refer to the price charged for the product, which includes actual product cost from the supplier, including the cost of transportation to the place of sale.

^bOperating costs are subsidized through appropriations because commissaries are not designed to be self-sustaining.

DeCA Plans to Pilot Changes to the Uniform Pricing Method

Specifically, DeCA plans to pilot changes to the uniform pricing method in response to a statutory provision. DeCA is working with the Boston Consulting Group to address a provision directing DOD to report on its plan to achieve budget neutrality for the commissaries and the exchanges, and authorizing pilot programs, including the use of variable

pricing, among other things.⁴⁴ As noted above, variable pricing is a common practice used by commercial grocery stores. It allows them to price some goods below cost, which generates a loss on that product but increases customer traffic to the store and potentially higher sales of other products. According to recent studies contracted by DOD, variable pricing could allow DeCA to price goods and compete more directly with private grocery stores nearby, which could increase commissary revenues. For example, the 2015 Boston Consulting Group study found that variable pricing would allow DeCA to correct for imbalances under uniform pricing that lead to some patrons in low cost-of-living areas receiving a lower than average savings benefit.⁴⁵ The study concluded that variable pricing would allow DeCA to provide a more consistent level of savings across regions and categories. This approach would help ensure a more uniform distribution of the desired savings rate among commissary patrons regardless of location. At the time of our review, DeCA officials could not confirm the time frames regarding when the pilot will be implemented.

DeCA Tracks Products Sold but Does Not Manage Products in a Manner Consistent with Practices Generally Employed in Commercial Grocery Stores

DeCA tracks the sale of products at all commissaries but does not assess the contribution of the sale of each product to a given store's total sales in determining which products to sell. In 2015, DeCA launched a system for scanning patron identity cards, which officials said has helped DeCA track shopping behavior at the commissaries. DeCA officials stated that they are also taking steps to analyze consumer shopping behavior to understand general trends at commissaries.⁴⁶ For example, DeCA plans to better understand consumer preferences by age, income, job position, and a variety of other demographics, to better target products that are sold at commissaries. Senior DeCA officials further stated that the agency

⁴⁴In April 2015, DOD requested legislative changes to the current pricing requirement that would allow DeCA to adopt "profit-based" practices, such as selling goods at a markup, and move away from the uniform price method. Although this legislative proposal was not adopted by Congress, Section 651 of the National Defense Authorization Act for Fiscal Year 2016 directs that DOD develop a plan to achieve budget neutrality for the commissary system by October 2018, including pilot programs that privatize the commissary system in whole or in part. See DOD, *Report on Plan to Obtain Budget Neutrality for the Defense Commissary System and the Military Exchange System*, May 2016.

⁴⁵Boston Consulting Group, *Military Resale Study*, 2015.

⁴⁶According to DeCA officials, DeCA is planning to analyze aggregate consumer information but it is not tracking individual customer shopping as is standard practice in the private retail sector.

conducted reviews of products on a regular basis to understand which products are top sellers and which are not performing well. DeCA officials explained how they use these product reviews to help assess customer demand and interest for new products. However, officials said that they do not consider the contribution of each product to a store's total sales in determining which products to sell. Similarly, according to the 2015 Boston Consulting Group study,⁴⁷ DeCA could improve its management of products based on a deep understanding of consumer preferences, shopping behavior, and product category management.

According to DeCA officials, because commissaries are focused on providing a benefit rather than on maximizing profitability or sales like commercial grocery stores, commissaries do not have clear goals or objectives related to customer demand. For example, commissaries do not always adjust products that commissaries carry based on customer demand. Conversely, according to studies of commercial grocery store practices and National Grocers Association officials,⁴⁸ efficient product management includes focusing on the contribution of products to the store's sales and providing products driven by customer demand so that stores are selling what their customers want to buy. In addition, according to commercial grocery store officials, the retail industry typically determines how many different brands of the same item (such as brands of ketchup or tuna) and how many different size containers of each brand that is most cost effective to stock. They generally include avoiding offering too many similar brands and sizes of similar products; instead, they typically limit the number of similar products offered to increase efficiency and sales margins.⁴⁹

Commissaries, on the other hand, may stock too many different brands and sizes of the same product, according to the Boston Consulting Group's 2015 study. This practice, known as "product proliferation" in the retail industry, can tie up funds in inventory without generating revenue, particularly for those brands or sizes that do not sell well at a given commissary. During site visits to 12 commissaries, we found some evidence of product proliferation. For example, we found five brands of

⁴⁷Boston Consulting Group, *Military Resale Study*, 2015.

⁴⁸Boston Consulting Group, *Military Resale Study*, 2015 and *Report of the Military Compensation and Retirement Modernization Commission*, 2015.

⁴⁹Bain and Company, *Focused Products: Streamlining Your Product Portfolio*, Mark Goltfredson and Chuck Whitten, 2012.

mayonnaise with 36 different sizes and flavors at one commissary. By comparison, a nearby commercial grocery store had just three different brands of mayonnaise and 18 different sizes and flavors.

DeCA officials said that they would like to be more efficient and improve product management based on store sales and customer demand, but DeCA does not have a plan with time frames and could not provide additional information about how it would achieve this goal. According to federal standards for internal control, management should design control activities to achieve objectives, and management should formulate plans to achieve its objectives and have oversight of control activities depending on the level of precision needed so that the entity meets its objectives.⁵⁰ Further, according to leading practices in project management,⁵¹ the establishment of clear, achievable objectives, goals, and time frames can help ensure successful project completion. Without a plan that clarifies the objectives, goals, and time frames DeCA will take to improve management of products based on store sales or customer demand as generally employed in commercial grocery stores, DeCA risks managing products inefficiently and missing opportunities to generate greater revenue streams and possibly cut costs.

DeCA Lacks Reasonable Assurance That Certain of Its Business Processes Are Cost Effective

DeCA lacks reasonable assurance that its business processes for stocking shelves, providing custodial services, and distributing products to its stores are cost effective. The agency has not conducted a cost-benefit analysis to review operational costs related to decision making on using in-house commissary staff for stocking and custodial services versus contractors. Similarly, the agency has not conducted a cost-benefit analysis to understand the costs associated with different distribution options across all commissaries. Employing cost-effective business processes is important to DeCA's ability to reduce its reliance on the annual appropriation while maintaining the desired patron savings rate.

⁵⁰ [GAO-14-704G](#).

⁵¹ [GAO/AIMD-00-21.3.1](#) and Project Management Institute, *A Guide to the Project Management Body of Knowledge* (PMBOK® Guide), 5th ed. (Newtown Square, PA: 2013). "PMBOK" is a trademark of the Project Management Institute, Inc. *A Guide to the Project Management Body of Knowledge* provides standards for project managers.

DeCA Has Not Compared Costs and Benefits of Using In-House Staff or Contractors for Shelf Stocking and Custodial Services

DeCA uses in-house staff to stock shelves and provide custodial services at some of its commissaries and contracts out for these services at other commissaries, but the agency could not provide a cost-benefit analysis to determine which approach results in lower operating costs. According to a recent study and private retailers with whom we spoke, most commercial grocery stores use in-house stocking because it allows for more flexibility and control over the management of inventory and staffing, which can lead to lower operating costs. We analyzed DeCA data for fiscal year 2015 and found that 154 commissaries had used service contracts for stocking and custodial services totaling \$137 million, about \$900,000 per commissary per year.⁵² During the same year, 81 commissaries used in-house staff for stocking and custodial services, and DeCA estimated the cost for in-house DeCA staff for these commissaries at about \$39 million, about \$500,000 per commissary per year.⁵³ Thus, at the time of our review, in-house stocking and custodial services cost on average about \$400,000 less. For example, based on our analysis of 49 small commissaries, 23 of the 49 stores had service contracts totaling \$7.5 million, or just over \$327,000 per commissary per year. By comparison, the remaining 26 stores used in-house stocking totaling \$6.6 million, or almost \$255,000 per commissary per year, a difference of almost \$72,000 on average.⁵⁴ We provided this analysis to DeCA and they acknowledged that contracting for stocking and custodial services cost more on average. Table 2 and figure 5 show the total and average costs of in-house stocking and custodial services compared with service contracts at commissaries of various sizes.

⁵²In fiscal year 2015, 8 commissaries, which used in-house DeCA staff for stocking, also had service contracts for custodial services only, totaling \$1.4 million.

⁵³For these 81 commissaries DeCA estimated that 742 full-time equivalent commissary staff were responsible for stocking. Eight of these 81 commissaries also had a service contract for custodial services. According to DeCA officials, 5 additional commissaries did not have service contracts and stocking was performed by in-house commissary staff.

⁵⁴We classified commissaries as small, medium, and large based on sales floor square footage. Small commissaries have 40,000 square feet or less, medium commissaries have 40,001 to 80,000 square feet, and large commissaries have 80,001 to 150,000 square feet.

Table 2: Costs for In-House Versus Contracted Stocking and Custodial Services, by Commissary Size for Fiscal Year 2015

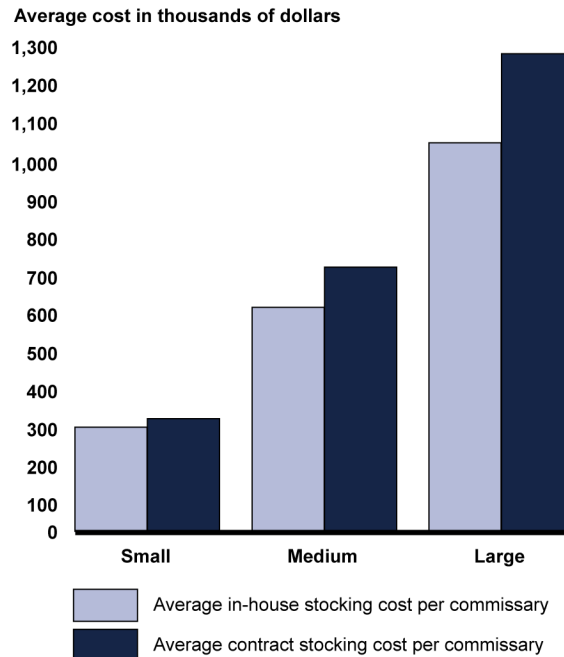
	In-house stocking (number of commissaries)	In-house stocking cost (millions of dollars)	Average in- house stocking cost per commissary (thousands of dollars)	Contracted stocking (number of commissaries)	Contracted stocking cost (millions of dollars)	Average contracted stocking cost per commissary (thousands of dollars)
Small	43	12	280	20	6	302
Medium	28	17	602	71	50	709
Large	10	10	1,043	63	81	1,282
Total	81	39	n/a	154	137	n/a

Legend: n/a=not applicable

Source: GAO Analysis of Defense Commissary Agency data. | GAO-17-80

Note: Commissaries are classified by sales floor square footage. Small commissaries have 40,000 square feet or less, medium commissaries have 40,001 to 80,000 square feet, and large commissaries have 80,001 to 150,000 square feet.

Figure 5: Comparison of Average Costs for In-House Versus Contracted Stocking and Custodial Services, by Commissary Size for Fiscal Year 2015



Source: GAO analysis of Defense Commissary Agency data. | GAO-17-80

Note: Commissaries are classified by sales floor square footage. Small commissaries have 40,000 square feet or less, medium commissaries have 40,001 to 80,000 square feet, and large commissaries have 80,001 to 150,000 square feet.

Federal standards for internal control and Office of Management and Budget (OMB) guidance state that management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations.⁵⁵ Further, these federal government guidelines also state that management should establish and monitor activities to evaluate costs associated with contracts. OMB guidance also promotes efficient resource allocation through well-informed decision making and provides guidance for a federal agency to perform sound cost-benefit and cost-effectiveness analyses.⁵⁶ These analyses should include elements such as comprehensive estimates of the expected benefits and costs of the program and alternative means of achieving objectives.

However, DeCA is continuing to implement service contracts for many of its stocking and custodial services without conducting cost-benefit analysis to determine whether this approach will reduce operating costs when compared with using in-house staff. Although DeCA conducted cost comparisons for two commissaries, DeCA has not performed cost comparisons or cost-benefit analysis for the remaining 238 commissaries. According to DeCA officials, the cost comparisons for the two commissaries were conducted because the service contractor had defaulted, and the cost comparison found that in-house stocking was more cost effective.⁵⁷ According to some DeCA officials, there are several reasons for using in-house stocking at a commissary, such as the lack of availability of a contractor, the location and size of commissaries, as well as staff experience, but the agency did not identify savings as a reason for using in-house stocking.

According to DeCA officials, cost-benefit analyses were not completed for all commissaries because it was not a requirement when DeCA was established in 1991. Further, officials stated that DeCA continued to use contracts inherited from the prior commissary system. Although DeCA's acquisition regulations require DeCA to review its service contracts

⁵⁵GAO-14-704G and OMB Circular No. A-123.

⁵⁶OMB Circular No. A-94.

⁵⁷In 2012, DeCA conducted a cost comparison for two commissaries, which resulted in a recommendation for in-house stocking to provide cost savings of about 15 percent for one location and 21 percent for the other location. According to DeCA officials, the cost comparisons were conducted because the contractor had defaulted on its service contract to provide stocking and custodial services and DeCA was unable to obtain another cost-effective service contract at those commissaries.

DeCA Lacks Reasonable Assurance That It Is Using the Most Cost-Effective Product Distribution System

annually to ensure contract performance, it has not compared the use of service contracts with the use of in-house DeCA staff for stocking and custodial services and instead continues to renew the contracts.⁵⁸ Without conducting a cost-benefit analysis to guide decisions about using in-house or contractor staff for stocking and custodial services at its commissaries, DeCA is not positioned to determine whether it is using its resources efficiently and effectively and is reducing operational costs.

DeCA has not conducted a cost-benefit analysis to fully understand the costs associated with different product distribution options across all commissaries and to use in selecting the most cost-effective option available for each commissary. After it was established in 1991, DeCA consolidated its logistics supply chains and transportation operations decisions at its headquarters based in Fort Lee, Virginia.⁵⁹ Generally, DeCA headquarters decided to rely on product manufacturers to transport products to commissaries.⁶⁰ The product manufacturers decide how to transport their products to DeCA commissaries, and they either deliver the products themselves or hire a third-party broker to arrange for deliveries. According to DeCA officials, although DeCA headquarters makes contracting decisions, local commissary officials have some discretion to consult with manufacturers on product distribution options. For example, some commissaries have distribution capabilities and, instead of direct delivery from the manufacturer, the products are delivered to a DeCA central distribution center.⁶¹ If products are delivered to a central distribution center, DeCA uses its own trucks to deliver products to commissaries. Figure 6 shows the different distribution options for delivering products to commissaries.

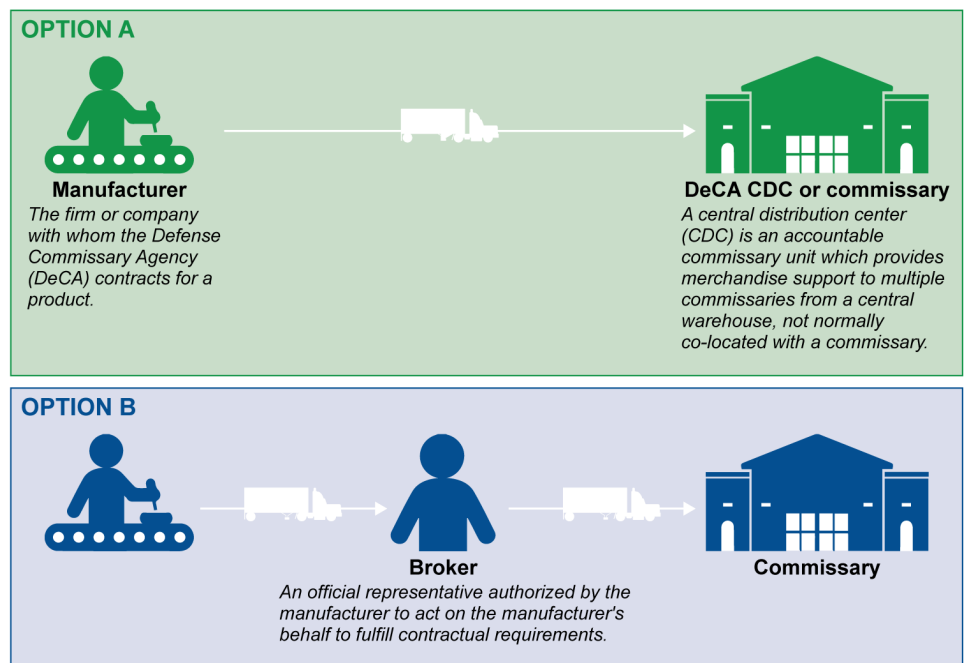
⁵⁸According to DeCA officials, service contracts for stocking and custodial services at commissaries are generally annual contracts with 4 option years.

⁵⁹Prior to the creation of DeCA, each military service ran its own commissary system.

⁶⁰First destination transportation costs are included in the price of the product paid by commissary patrons.

⁶¹The central distribution center is a commissary unit that provides merchandise support to multiple commissaries from a central warehouse.

Figure 6: Product Delivery Options for DeCA Commissaries



Source: GAO analysis of Defense Commissary Agency data. | GAO-17-80

Although contracting decisions for commissary products are made at DeCA headquarters, some local commissary officials stated that they have been able to negotiate directly with manufacturers and achieve some cost savings in the quantities purchased and directly delivered. For example, according to DeCA officials, some commissaries can reduce the price of products by leveraging high-selling nonperishable items (e.g., water and energy drinks) and achieving economies of scale by buying large amounts of such items directly from a manufacturer rather than receiving those items in smaller quantities from third-party brokers. Specifically, DeCA officials stated that commissaries could negotiate with manufacturers by leveraging the volume of a truckload of specific products, thereby reducing the wholesale price of that product—a savings that would be reflected in a lower retail price for patrons. According to some DeCA officials, in addition to larger stores receiving truckloads of items, a truckload of products can also be split among several smaller stores located close to each other. Based on an example from a senior DeCA official from a large commissary, we found that if the commissary is able to accept a truckload of bottled water on a weekly basis there is a potential of \$552,500 annual savings on the cost of such water, compared with relying on a third-party distributor to provide individual pallets of

water in separate deliveries. Although there could be potential cost savings, DeCA has not conducted a cost-benefit analysis to understand product distribution options and potential cost savings.

Another product distribution option that could provide cost savings is to use a central distribution center or larger commissary. Specifically, some commissaries use a central distribution center or larger commissary to receive products from manufacturers and then distribute products directly to or between commissaries, rather than receiving direct delivery from a manufacturer to a commissary. Specifically, DeCA currently operates five product-delivery vehicles located at larger commissaries that support one or two smaller commissaries that are unable to receive large truckloads of products. The total cost for five vehicles is approximately \$64,000 to operate annually, not including driver salaries. DeCA uses these vehicles to leverage storage space and reduce costs for other smaller commissaries located nearby. In addition to providing manufacturer products to the smaller commissaries, DeCA could use its trucks to provide meat to smaller commissaries. According to a senior DeCA official, a smaller commissary may not need staff to operate certain in-store departments such as a meat department if a nearby larger commissary can deliver meat products on a regular basis using DeCA's truck. Further, according to DeCA officials, some other commissaries also have the potential to leverage their size and location to provide meat for commissaries located nearby, which would eliminate the need for a meat department at each of the smaller, co-located commissaries. Based on the example from a DeCA commissary official, we found that five commissaries in a regional zone could source their meat from a central commissary, and DeCA could potentially avoid the cost of 50 full-time equivalent salaries to operate a meat department in those five commissaries. Based on this example, we estimate that the potential cost avoidance at five commissaries is about \$2 million annually.⁶²

According to federal government guidelines,⁶³ management should establish and monitor activities to evaluate the costs associated with

⁶²The potential salary cost avoided is based on full-time equivalent estimates for five commissaries located within 70 miles of the commissary centrally distributing the meat. The total potential cost avoidance would also have to take into account the cost of the following: the annual costs to operate a DeCA vehicle, which can range from \$10,000 to \$16,000 and the salaries of additional staff required to operate the meat department, which can range from \$32,000 to \$76,000 for one staff member.

⁶³[GAO-14-704G](#) and OMB Circular No. A-123.

contracts. Furthermore, federal guidelines promote efficient resource allocation through well-informed decision making and provide guidance for a federal agency to perform sound cost-benefit and cost-effectiveness analyses.⁶⁴ These analyses should include elements such as comprehensive estimates of the expected benefits and costs of the program and alternative means of achieving objectives.

However, DeCA has not conducted cost-benefit analysis to fully understand the costs associated with different distribution options across all commissaries. According to DeCA officials, DeCA did not conduct such cost-benefit analysis because it was not required by DOD or Congress. Further, DeCA officials stated that DeCA was accustomed to using the existing distribution network established when DeCA was created in 1991. Without a cost-benefit analysis, however, DeCA lacks a data-driven rationale for choosing product distribution options that could be more efficient and beneficial for commissary operations and patrons.

Conclusions

Although DeCA is implementing or considering business process improvements at defense commissaries, the agency continues to use certain business processes that are not consistent with those generally employed by commercial grocery stores. First, DeCA states it is achieving its desired 30 percent savings rate for commissary patrons; however, DeCA's methodology for calculating this rate has certain limitations. By relying on a process that does not include a random sampling method and does not account for seasonal or geographic differences in price, among other limitations, DeCA cannot be assured that the commissary system is delivering the desired savings rate to all commissary patrons. Second, DeCA collects information to help manage the products sold at commissaries, but there are weaknesses to this approach that can limit DeCA's ability to operate efficiently. In particular, DeCA has not focused on improving the management of products based on consumer demand and consequently may be missing potential opportunities to improve sales, leverage efficiencies, and achieve savings in commissary operations. Third, DeCA has not conducted a cost-benefit analysis for its service contracts for stocking and custodial services and for distributing products to commissaries. For example, DeCA uses service contracts for stocking at most commissaries, even though in-house stocking has been shown to be less costly. Without analyzing the costs and benefits of its

⁶⁴OMB Circular No. A-94.

stocking, custodial, and distribution processes, the agency lacks reasonable assurance that it is identifying potential operational efficiencies and costs savings.

As a result of using certain business processes that depart from those used by commercial grocery stores, DeCA is missing opportunities to reduce its operating costs and potentially to reduce its reliance on the annual appropriation while providing the patron savings rate that constitutes the noncash benefit provided by the commissary system. Moreover, should the Congress wish to privatize in whole or in part the defense commissary system, the continued reliance on business processes not used by commercial grocery stores can make the commissaries less attractive to potential private-sector businesses that might be interested in operating the defense commissaries.

Recommendations for Executive Action

To provide greater assurance that defense commissaries are achieving the desired savings rate for patrons, we recommend that the Secretary of Defense direct the Chief Executive Officer of DeCA, as DeCA revises its methodology for calculating the savings rate, to address the limitations that we identified, including those related to seasonal differences in prices, the sampling methodology for overseas commissaries, geographic differentiation, and the calculation of the weighted average.

To improve operational efficiencies and reduce costs related to product management and services that support commissary operations, we recommend that the Secretary of Defense direct the Chief Executive Officer of DeCA to take the following two actions:

- Develop a plan with objectives, goals, and time frames on how it will improve efficiency in product management, such as offering products based on store sales or customer demand.
- Conduct comprehensive cost-benefit analyses to guide decisions on implementing the most cost-effective option as stocking and custodial services contracts are renewed, and on choosing product distribution options.

Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD concurred with two recommendations and partially concurred with one recommendation. DOD's comments are summarized below and reprinted in their entirety in appendix II. DOD also provided technical comments on the draft report, which we incorporated as appropriate.

DOD concurred with our recommendation to address the limitations that we identified as DeCA revises its methodology for calculating the savings rate, including those related to seasonal differences in prices, the sampling methodology for overseas commissaries, geographic differentiation, and the calculation of the weighted average. In its comments, DOD noted that it has established a new baseline for patron savings as well as a revised methodology that compares regional savings levels with prices at commercial grocery stores near commissaries. This action could meet the intent of our recommendation if it helps address the limitations we identified in our report.

DOD also concurred with our second recommendation to develop a plan with objectives, goals and timeframes on how to improve efficiency in product management. DOD stated that it plans to implement two variable pricing programs and private labeling, which would help improve category management by using private sector practices to improve product offerings and reduce costs. DOD also stated that it plans to implement any changes to product offerings beginning in April 2017. For example, DOD identified 10 commissaries to participate in an effort to improve patrons' overall shopping experience by gradually ensuring a more consistent savings level across categories of products throughout a store through correcting the prices on key items where patrons experience lower than expected savings. Additionally, DOD stated that plans to introduce private labeled products to create incremental cost efficiencies with the goal of offsetting DECA's reliance on appropriated funding.

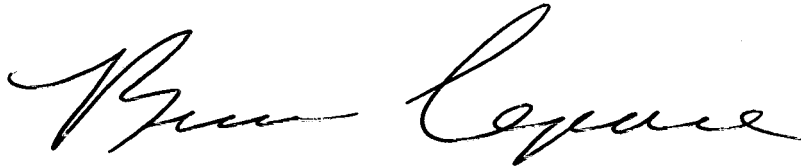
Finally, DOD partially concurred with our recommendation to conduct comprehensive cost-benefit analyses to guide decisions on implementing the most cost-effective option as stocking and custodial services contracts are renewed, and on choosing product distribution options. The department stated that authorizing legislation would be required to implement this recommendation. Specifically, DOD pointed to requirements in the Javits-Wagner-O'Day Act that DOD acquire certain services from nonprofit agencies that serve the blind and the disabled and provisions in the Federal Acquisition Regulation that require DOD to set aside procurements exclusively for various categories of small business concerns under specified circumstances. Finally, DOD cited Office of

Management and Budget Circular A-76 and the Service Contract Labor Standards as presenting additional impediments to implementing our recommendation. With respect to product distribution options, DOD stated that it does not believe there is a demonstrable need to conduct a cost-benefit analysis. DOD stated that DeCA purchases items either delivered to commissary's back door or to the commissary shelf, which includes transportation costs, and is authorized to use appropriated funds for transportation costs within and outside the United States.

We recognize that DOD operates in an environment that requires strict adherence to various mandates, both statutory and regulatory. While DOD has cited a number of laws and regulations that apply once it has made a decision to contract out for the performance of a function, the Department did not cite a specific provision that would prevent it from conducting a cost-benefit analysis to make an informed decision whether to contract for services or to perform them in-house. For example, although the Federal Acquisition Regulation requires the use of set asides for specified socioeconomic categories of contractors, DOD has not identified any provision in the regulation that would prevent it from analyzing the costs of using one or more of these contractors to perform a function compared to the cost of performing the function using in-house resources. With respect to product distribution options, we found in our report that DeCA could potentially achieve a total of \$2 million annually in cost avoidances for its product distribution costs at five commissaries. In its comments, DOD does not provide any rationale for why it should not pursue such cost avoidances for its product distribution. Therefore, we continue to believe that our recommendation is valid and that DOD should use a data-driven approach and conduct a cost-benefit analysis to fully understand the costs associated with stocking and custodial services contracts and its different distribution options. Given the constrained budget environment, we believe DOD needs to explore all available opportunities to achieve efficiencies.

We are sending copies of this report to the appropriate congressional committees; the Secretary of Defense; the Chief Executive Officer of the Defense Commissary Agency; the Secretaries of the Army, the Navy, and the Air Force and the Commandant of the Marine Corps; and the Director of the Office of Management and Budget. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at 202-512-4523 or leporeb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

A handwritten signature in black ink, reading "Brian Lepore". The signature is fluid and cursive, with the first name "Brian" and the last name "Lepore" clearly distinguishable.

Brian J. Lepore
Director, Defense Capabilities and Management

Appendix I: Scope and Methodology

To address both objectives of this report, we conducted site visits to a nongeneralizable sample of 12 commissaries to identify information on commissary operations at the local level. We selected these commissaries based on location, sales, operating costs, and representation of all military services. The 12 commissaries we visited were located at Fort Belvoir, Naval Air Station Oceana, Joint Expeditionary Base Little Creek-Fort Story, and Fort Lee, Virginia; Tobyhanna Army Depot, Pennsylvania; Schofield Barracks, Joint Base Pearl Harbor-Hickam, and Kaneohe Bay Marine Corps Base, Hawaii; and Naval Base San Diego, Naval Air Facility El Centro, and Marine Corps Air Ground Combat Center Twentynine Palms, California. In each commissary, we analyzed product prices and savings and how products were managed, sold, and stocked. In each commissary, we met with local commissary staff to discuss our observations, the costs and benefits associated with contracting for services compared with using in-house staff for stocking and custodial services, and the product distribution options used at the commissary. Although the site visits constitute a nongeneralizable sample, they helped augment information we obtained from Defense Commissary Agency (DeCA) headquarters and other sources.

To evaluate the extent to which the Department of Defense (DOD) has assurance it is maintaining the savings rate for patrons that represents the nonpay cash benefit, we reviewed DeCA's current savings methodology that calculates the savings rate that patrons realize by using commissaries instead of private retailers from fiscal years 2010 through 2015, the latter being the most recent available fiscal year for which data were available at the time of our review. We compared DeCA's savings methodology with relevant leading practices for cost estimating and sampling, such as sampling standards established by the American Association for Public Opinion Research Report Task Force on Non-Probability Sampling,¹ and with federal standards for internal control, which states that management should have relevant and reliable information to run an agency's operations and the data should be reasonably free of error and bias and represent what they were purported

¹We used the American Association for Public Opinion Research Report Task Force on Non-Probability Sampling as an authoritative source for sampling because it identifies the strengths and weaknesses of key sampling methods related to the use of probability and nonprobability samples for making inferences from a sample to a larger population. Reg. Baker et al, *Report of the American Association for Public Opinion Research Task Force on Non-Probability Sampling*, June 2013.

to represent.² We also compared DeCA's methodology with private sector practices identified in recent studies, specifically the private sector's local pricing strategies, which consider competition from local retail grocery stores in setting prices rather than nationwide prices and include private-label items.³ We interviewed DeCA officials responsible for collecting, tracking, and analyzing sales, prices, costs, and savings information at DOD commissaries to corroborate our understanding of DeCA's methodology for calculating DeCA's patron savings rate.

To identify differences in business practices between commissary operations and commercial grocery store practices, we reviewed (1) DOD's pricing method, (2) management of products, and (3) cost-benefit analyses of service contracts and transportation distribution costs. First, to describe DOD's current pricing method and any planned changes to the method, we reviewed DeCA's pricing method as required by statute, and compared DeCA's pricing method with methods used in the private sector.⁴ We identified private sector practices by reviewing studies and leading practices that describe operational efficiencies achieved in the private sector through practices such as private labeling and variable pricing.⁵ We also interviewed private sector grocers and retailer associations to identify private sector practices for operating retail grocery

²[GAO-14-704G](#).

³For the purposes of this report, we simply described recent studies. Private label items are products generally intended to be comparable to and sometimes less expensive than name branded products and are commonly referred to as "store brands." At present, commissaries do not carry private label items.

⁴Section 2484(e) of Title 10 of the U.S. Code sets forth how commissary item sale prices are to be established. Federal Accounting Standards Advisory Board, *Federal Accounting Standards Advisory Board Handbook of Federal Accounting Standards and Other Pronouncements*, June 30, 2015. Unlike in the case of private sector retailers, DeCA's pricing methodology does not allow for variable pricing and is not based on generally accepted accounting standards for accounting for product prices. Variable pricing allows retailers to vary the price of goods to cover operating costs and capital expenditures and to generate a profit.

⁵See Boston Consulting Group, *Military Resale Study*, July 10, 2015; Military Compensation and Retirement Modernization Commission, *Report of the Military Compensation and Retirement Modernization Commission*, 2015; RAND, *The Likely Effects of Price Increases on Commissary Patronage: A Review of the Literature*, 2015; Booz Allen Hamilton Inc., *Independent Study of Defense Commissary Agency's Engineering Directorate*, 2014; Dove Consulting, *Variable Pricing Feasibility Assessment for Defense Commissary Agency*, 2004; and Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options*, 2011.

stores. We also reviewed DeCA's plans to change its current pricing method and how that plan compares with private sector practices.

Second, to evaluate the extent to which DOD efficiently manages products sold at the commissaries, we compared DOD objectives and guidance to maintain an efficient system of commissaries with practices generally employed in the private sector. We also reviewed DeCA's management of the inventory of products and compared this management with pertinent studies and leading practices that analyze private sector grocery retail practices based on operational efficiencies related to the management of products and customer demand.⁶ We also compared DeCA's implementation of a new system for category management with federal standards for internal control, which states that management should design control activities and formulate plans to achieve objectives and respond to risk, and management should have oversight of control activities depending on the level of precision needed so that the entity meets its objectives.⁷ We also interviewed DeCA officials responsible for managing products sold in commissaries, including those officials at the 12 commissaries we visited, to assess product management practices.

Third, to assess the extent to which DOD conducts cost-benefit analyses for service contracts and distribution options, we reviewed DeCA's guidance and policies for reviewing contracts, including service, product distribution, and resale goods contracts. For service contracts, we reviewed service contracts for the stocking and custodial services. We also reviewed the costs associated with in-house stocking performed by DeCA commissary staff. For fiscal year 2015, we compared DeCA's data on the costs associated with service contracts for stocking and custodial services and in-house stocking performed by DeCA employees. We analyzed service contracts for stocking and custodial services for 11 of the 12 commissaries we visited in the United States. The remaining

⁶See Boston Consulting Group, *Military Resale Study*, July 10, 2015; Military Compensation and Retirement Modernization Commission, *Report of the Military Compensation and Retirement Modernization Commission*, 2015; RAND, *The Likely Effects of Price Increases on Commissary Patronage: A Review of the Literature*, RAND, 2015; Booz Allen Hamilton Inc., *Independent Study of Defense Commissary Agency's Engineering Directorate*, 2014; Dove Consulting, *Variable Pricing Feasibility Assessment for Defense Commissary Agency*, 2004; and Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options*, 2011. ⁷[GAO-14-704G](#).

⁷[GAO-14-704G](#).

commissary we visited did not have a service contract, and stocking was performed in-house by DeCA commissary staff. For product distribution costs, we reviewed costs associated with DeCA owned or leased vehicles and DeCA warehouses both domestically and overseas, as well as other options for product distribution. We compared DeCA's practices, guidance, and policies,⁸ for deciding to contract for services with federal government guidelines in the Office of Management and Budget's Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs, federal standards for internal control, and the Office of Management and Budget's Management's Responsibility for Internal Control.⁹ We interviewed DeCA headquarters officials and officials at local commissaries responsible for contracting to understand the agency's contracting practices and policies and to assess the implementation of contracts at the local level.

We assessed the reliability of the data provided by DeCA by (1) reviewing related documentation, such as recent studies and (2) interviewing DeCA officials who were knowledgeable about the data. We asked the officials questions intended to assess the reliability of the data. On the basis of procedures performed, we have concluded that these data were sufficiently reliable for the purposes of reporting on data related to savings, sales and salaries used for contracting and custodial services.

We conducted this performance audit from September 2015 to March 2017 in accordance with generally accepted government auditing standards.¹⁰ Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We

⁸Defense Commissary Agency Acquisition Regulation Supplement (DeCAARS), 2005.

⁹See Office of Management and Budget, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*, OMB Circular No. A-94 (October 1992); GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014), which calls for efficient resource allocation through well-informed decision-making and provides guidance for a federal agency to perform sound benefit-cost and cost-effectiveness analyses; and Office of Management and Budget, *Management's Responsibility for Internal Control*, OMB Circular No. A-123 (revised 2004), which states that management should establish and monitor activities to evaluate costs associated with contracts.

¹⁰We provided a briefing of our preliminary observations to the Senate Armed Services Committee and House Armed Services Committee in January 2016.

believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Defense



DEFENSE COMMISSARY AGENCY
HEADQUARTERS
1300 E AVENUE
FORT LEE, VIRGINIA 23801-1800

MAR 8 2017

Mr. Brian J. Lepore
Director, Defense Capabilities and Management
U.S. Government Accountability Office
441 G Street, NW
Washington DC 20548

Dear Mr. Lepore:

This is the Department of Defense (DoD) response to the GAO Draft Report GAO-17-80, "Defense Commissaries: DOD Needs to Improve Business Processes to Ensure Patron Benefits and Achieve Operational Efficiencies," dated January 19, 2017 (GAO Code 100176).

The Department is providing official written comments for inclusion in the report.

Sincerely,

A handwritten signature in black ink, appearing to read "Joseph H. Jeu".

Joseph H. Jeu
Director and Chief Executive Officer, SES
Defense Commissary Agency

Attachment

Your Commissary ... It's Worth the Trip!

GAO DRAFT REPORT DATED JANUARY 19, 2017
GAO-17-80 (GAO CODE 100176)

“DEFENSE COMMISSARIES: DOD NEEDS TO IMPROVE BUSINESS PROCESSES
TO ENSURE PATRON BENEFITS AND ACHIEVE OPERATIONAL EFFICIENCIES”

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION

RECOMMENDATION 1: The GAO recommends that the Secretary of Defense direct the Chief Executive Officer, Defense Commissary Agency (DeCA), to provide greater assurance that defense commissaries are achieving the desired savings rate for patrons, as DeCA revises its methodology for calculating the savings rate, including those related to seasonal differences in prices, sampling methodology for overseas commissaries, geographic differentiation, and calculation of the weighted average.

DoD RESPONSE: Concur. Pursuant to section 651(e)(3) of the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2016 (P.L. 114-92), and section 661(c) of the NDAA for FY 2017 (P.L. 114-328), the Department has established a new baseline for patron savings. The new baseline identifies:

- A savings level for U.S. commissaries by region, 7 regions in total
- A quarterly savings level
- A savings level that measures a representative market list of items
- A savings level that incorporates pricing of local competitors

To meet these objectives, DeCA has developed a methodology with three parts:

1. A manual market basket shop component of up to 1,400 Stock Keeping Units (SKUs) that reflect products patrons normally purchase. This comparison will be conducted at the commissary as well as selected commercial stores in the vicinity of the commissary. The market basket data obtained will be used to calculate a commissary regional savings level as compared to commercial stores around each commissary. Each U.S. Commissary will be manually shopped once a year, at a rate of approximately 45 stores per quarter. The commissary savings levels collected each quarter will be combined via a sales-weighted average to derive an overall manual approach savings metric on a regional basis.
2. A data-driven component with the largest possible range of items and competitors to ensure comprehensiveness by comparing the prices of all scannable products that DeCA carries (about 38,000 SKUs) to a database of average national prices. The data component, calculated on a monthly basis, will be used to monitor trends in savings.
3. An OCONUS adjustment to account for overseas cost of living differences by applying the Defense Travel Management Office (DTMO) Cost of Living Index to the CONUS savings

calculation. The primary inputs to the overseas approach are the U.S. savings levels for the East and West coasts, and the cost of living allowance (COLA) index for each overseas location.

The new baseline of patron savings is:

	Commissaries	Savings %*
New England	36	21.4%
South Atlantic	30	19.9%
South Central	33	18.1%
Pacific	31	20.9%
Mountain	20	17.6%
North Central	18	20.2%
Alaska / Hawaii	9	32.6%
US Average	177	20.2%
Overseas	61	44.2%
Global Average	238	23.7%

* Calculation includes applicable taxes in commercial grocery store prices and surcharge in commissary prices; without these, savings would be US (22.3%); Overseas (45.6%); Global (25.7%). 35 States (70%) do not have sales tax on food items.

Pursuant to section 661(a) of the NDAA for FY 2017, the Department briefed the Congressional defense committees on the new savings methodology on January 26th and 27th, 2017.

RECOMMENDATION 2: The GAO recommends that the Secretary of Defense direct the Chief Executive Officer, Defense Commissary Agency (DeCA), to develop a plan with objectives, goals, and timeframes on how it will improve efficiency in product management, such as offering products based on store sales or customer demand.

DoD RESPONSE: Concur. It should be noted that since the preparation of the draft GAO report, Congress enacted the National Defense Authorization Act for Fiscal Year 2017. Section 661(c) of P.L. 114-328 permanently authorized the implementation of a variable pricing program by the defense commissary system. The Department notified Congress, through the above-mentioned briefings to the Congressional defense committees on January 26th and 27th, 2017, that it intends to implement two variable pricing programs and deploy a line of private label products.

Category Based: Category performance improvement is a commercially-proven practice of working with suppliers to optimize the assortment, improve the patron product offering and reduce costs. It focuses the assortment on the best-performing suppliers and products in terms of savings level, cost effectiveness and customer preference. It reallocates shelf space in ways that make it easier for customers to navigate and easier for stores to keep well-stocked, and that focus

the assortment on items that customers care about and that offer good savings. Almost all commercial retailers undertake this kind of process on a regular basis.

DeCA analyzes sales data, patron loyalty, comparable commercial data, and vendor costs to identify performance gaps in the current assortment. DeCA then enters into commercial negotiations that improve the performance of suppliers, strengthen key supplier relationships, and deliver an assortment that better meets customer needs. These negotiations address topics such as dollar and unit sales, product costs, shelf space allocation, shipment requirements, store level support, and promotional activity and support. Throughout this effort, except for normal market fluctuations, DeCA will maintain average shelf prices at current levels or better in order to ensure that the patron benefit remains unchanged. Cost efficiencies achieved will be used to offset DeCA's operating costs.

Although DeCA will maintain a full assortment of products comparable to any commercial grocer, some low-performing items (and in limited cases, some brands) may be taken off the shelves altogether. DeCA takes any such decisions very seriously and will use robust data analysis to ensure that the overwhelming majority of customers either have no preference for that product/brand, or are able to find a comparable substitute that meets their needs.

DeCA has identified 6 major categories (out of a total 40) to optimize in the first phase of activity. These were selected to cover a wide variety of categories, attempting to get a mix of size, competitive intensity, and brand strength. The first wave includes about 6,000-8,000 items or approximately 20% of DeCA's current assortment. The first wave of categories will conclude negotiations during FY 17's second quarter. Thereafter DeCA will continue negotiating the remainder of the major categories which is anticipated to take 18 months to complete.

The main operational component of this effort will be to implement any changes to the assortment or shelf layout. This will not impact stores until several months into the rollout when shelves are reset. Resetting shelves is an activity that DeCA conducts on a frequent basis, and DeCA's operations team will follow its existing shelf reset processes, working closely with store employees as well as any relevant distributors / vendors to ensure smooth implementation of any shelf changes. Resets to implement the first wave are targeted to begin in April 2017.

This effort will be conducted at all commissary locations in the United States and overseas.

Store-Based: In a limited number of stores, DeCA is focusing on a variety of items across the stores that are currently very misaligned with the market (i.e., they offer extremely high or extremely low savings vs. private sector grocers). These priority items were selected based on purchase volume and frequency, together with current savings levels compared to average national market prices. Priority items include a balanced mix of price-ups and price-downs, to safeguard patron savings and control investment levels. Examples of priority items considered for reduced prices (i.e., high volume/frequency of purchase, low savings rate) include: mayonnaise, baby food, canned soup, almond milk, orange juice, salad dressing, dish detergent, and canned beans. Examples of priority items for price increases (i.e., lower volume/frequency

of purchase, high savings rate) are: coffee creamers, batteries, vitamins and supplements, paper napkins, and light bulbs.

DeCA initially plans to adjust the prices of up to 1,400 of these items across the store (less than 5 percent of the total assortment of products within the store). With this approach, DeCA hopes to improve patrons' overall shopping experience by gradually ensuring a more consistent savings level across categories throughout the store, correcting the prices on key items where patrons experience lower than expected savings.

DeCA has identified 10 commissaries to participate in the initial rollout of this project, selected based on a range of analytical and operational criteria, including:

- Mix of geographic locations (CONUS locations, east/west/central and urban/rural)
- Mix of competitive intensity (areas with many vs. few commercial competitors)
- Mix of store sizes (\$15M to \$50M+ annual sales)
- Mix of patron base (military service branch, active duty and retiree)
- Consistent year-on-year sales trends (to enable effective measurement)
- Distance from other commissary locations (to minimize cross-shopping confusion)

Private Label: In addition to optimizing its existing assortment DeCA will introduce private label products to its shelves. Private label products are a store brand alternative to name brand products. They can be produced at a similar quality to name-brand equivalents (often even produced on the same manufacturing lines) but can be sourced and sold at much lower cost. The prices of these products will be set based on the competitive dynamics of the category, market prices, and customer preferences (i.e., price sensitivity for the particular product). Any incremental cost efficiencies generated by these products (that is, any difference between the prices paid at the register and the costs incurred by DeCA) will be handled the same way as efficiencies from the Category Performance Improvement effort, and will help offset DeCA's reliance on appropriated funding.

RECOMMENDATION 3: The GAO recommends that the Secretary of Defense direct the Chief Executive Officer, Defense Commissary Agency (DeCA), to conduct comprehensive cost-benefit analyses to guide decisions on implementing the most cost-effective option as stocking and custodial services contracts are renewed, and on choosing product distribution options.

DoD RESPONSE: Partially concur. Authorizing legislation is required. While the cost comparison numbers reflected within the GAO report make a compelling argument for a simple cost-comparison analysis, the report does not convey the fact that as a DoD agency, DeCA conducts its procurements in accordance with the Federal Acquisition Regulation (FAR), which require, in certain circumstances, that DeCA contracts support socio-economic programs. For example, DeCA currently administers 162 commercial activity (CA) contracts for shelf stocking, custodial, and receiving/storage/holding area services. Of those 162 contracts, 99 are executed and administered pursuant to the Javits-Wagner-O'Day (JWOD) Act (41 U.S.C. §85001 et seq.), which requires that if DeCA intends to procure a product of service on the procurement list established pursuant to 41 U.S.C. 8503, DeCA shall procure the product or service from a

qualified nonprofit agency for the blind or a qualified nonprofit agency for other severely disabled in accordance with the regulation of the Committee for Purchase from People Who Are Blind or Severely Disabled (now called the Ability One Commission) and at a price established by the Ability One Commission if the product or service is available within the period required by DeCA. Historically, the Ability One Commission has considered the fair market price for a product or service to be a cost that is within 10% of an acceptable commercial market price. The balance of these CA contracts (63 each) is set aside exclusively for small business concerns, as required by the FAR. These contracts include set-asides for a number of sub-categories, to include: small-disadvantaged business (SDB) concerns, Small Business Act - Section 8(a) concerns, HUBZone qualified small business concerns, woman-owned small business (WOSB) concerns, veteran-owned small business (VOSB) concerns, and service-disabled veteran-owned (SDVO) concerns. The DoD Office of Small Business Programs assigns annual DeCA "goals" for each of these sub-categories.

Also of note is the fact that at least some of these contracted functions were originally a direct result of an OMB Circular A-76 Cost Comparison study. Reversal of those studies may require legislative relief. Finally, as a federal agency, DeCA is compelled to comply with the Service Contract Labor Standards (41 U.S.C. § 67), which mandates the minimum wages and health benefits that the contractor must pay its employees for these services. Labor costs are a predominant portion of any service contract, and these mandatory requirements effectively limit any contractor's ability to freely manage these factors.

In order to consider a business plan based purely on the estimated costs of contracted versus in-house services, DeCA would first need to be provided relief from these mandated sources and associated costs. When DeCA raised this issue in the past as a barrier to minimizing contract costs, the Department has been reluctant to pursue or provide such relief.

As to product distribution options, in the United States, DeCA purchases items either delivered to commissary's back door or to the commissary shelf, which includes transportation costs. Goods destined for overseas shipments include delivery cost to the port of embarkation. 10 U.S.C. 2483(b)(5) authorizes the use of appropriated funds for second destination transportation costs within and outside the United States. Consequently, the Department does not believe there is a demonstrable need to conduct a cost-benefit analysis.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Brian J. Lepore, (202) 512-4523 or leporeb@gao.gov

Staff Acknowledgments

In addition to the individual named above, key contributors to this report were Gina Hoffman (Assistant Director), Pedro Almoguera, Bonita Anderson, James Ashley, Pat Bohan, Tim DiNapoli, Timothy Guinane, Amie Lesser, Alice Paszel, Terry Richardson, Sabrina Streagle, Elizabeth Wood, Bill Woods, and Yee Wong.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's website (<http://www.gao.gov>). Each weekday afternoon, GAO posts on its website newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to <http://www.gao.gov> and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's website, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

Connect with GAO

Connect with GAO on [Facebook](#), [Flickr](#), [LinkedIn](#), [Twitter](#), and [YouTube](#). Subscribe to our [RSS Feeds](#) or [E-mail Updates](#). Listen to our [Podcasts](#). Visit GAO on the web at www.gao.gov and read [The Watchblog](#).

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Website: <http://www.gao.gov/fraudnet/fraudnet.htm>

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Katherine Siggerud, Managing Director, siggerudk@gao.gov, (202) 512-4400, U.S. Government Accountability Office, 441 G Street NW, Room 7125, Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800, U.S. Government Accountability Office, 441 G Street NW, Room 7149, Washington, DC 20548

Strategic Planning and External Liaison

James-Christian Blockwood, Managing Director, spel@gao.gov, (202) 512-4707, U.S. Government Accountability Office, 441 G Street NW, Room 7814, Washington, DC 20548



Please Print on Recycled Paper.